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# FINANCIAL MANAGEMENT

# Federal Financial Management Improvement Act Results for Fiscal Year 1999

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Accounting and Information
Management Division

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September 29, 2000

The Honorable Fred Thompson
Chairman
The Honorable Joseph I. Lieberman
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

The Honorable Dan Burton
Chairman
The Honorable Henry A. Waxman
Ranking Minority Member
Committee on Government Reform
House of Representatives

The inability to produce the data needed to efficiently and effectively manage the day-to-day operations of the federal government and provide accountability to taxpayers historically has been a major weakness at most of the largest federal agencies. The central challenge in generating such data is overhauling inadequate and outdated accounting and financial-related management information systems. To help focus attention on this challenge, the Congress passed the Federal Financial Management Improvement Act of 1996 (FFMIA),[1] which requires the 24 major departments and agencies named in the Chief Financial Officers (CFO) Act to implement and maintain financial management systems that comply substantially with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the *U.S. Government Standard General Ledger* (SGL)[2] at the transaction level.

[1]Title VIII of Public Law 104-208 is entitled Federal Financial Management Improvement Act of 1996.

[2]The SGL provides a standard chart of accounts and standardized transactions that agencies are to use in all their financial systems.

FFMIA requires auditors to report, as part of their audit reports on the agencies' annual financial statements, whether their respective financial management systems comply with FFMIA's requirements. FFMIA also requires that we report annually on FFMIA implementation by October 1 of each year. Our annual report addresses (1) compliance of CFO Act agencies' financial systems with FFMIA's requirements, (2) agencies' plans to bring their systems into compliance, and (3) other efforts to improve the government's financial management systems. Last year, we issued the third of our annual reports under FFMIA, which covered fiscal year 1998.[3]

## Results in Brief

For fiscal year 1999, auditors for 21 of the 24 CFO Act agencies reported that the agencies' financial systems did not comply substantially with FFMIA's requirements—federal financial management systems requirements, applicable federal accounting standards, and the SGL. These results were similar to those for fiscal years 1997 and 1998. As a result, the vast majority of agencies' financial management systems fall short of the CFO Act and FFMIA goal to provide reliable, useful, and timely information on an ongoing basis for day-to-day management and decision-making. Reasons for systems' noncompliance include nonintegrated systems, inadequate reconciliation procedures, noncompliance with the SGL, lack of adherence to accounting standards, and weak security over information systems.

Although the financial management systems of most agencies do not yet comply with FFMIA's requirements, the number of agencies receiving "clean" or unqualified audit opinions[4] is increasing. Fifteen of the 24 CFO Act agencies received unqualified audit opinions on their financial statements for fiscal year 1999, up from 12 in fiscal year 1998 and 11 in fiscal year 1997. Auditors of 12 of the 15 agencies that received unqualified opinions reported however that the agencies' financial systems did not comply substantially with FFMIA's requirements in fiscal year 1999.

[3] *Financial Management: Federal Financial Management Improvement Act Results for Fiscal Year 1998* (GAO/AIMD-00-3, October 1, 1999).

[4] In an unqualified opinion, the auditor concludes that the principal statements and accompanying notes present fairly, in all material respects, the assets, liabilities, and net position of the entity at the end of the period, and the net costs, changes in net position, budgetary resources, and reconciliation of net costs with budgetary obligations for the period then ended.

Through the rigors of the financial statement audit process and the requirements of FFMIA, agencies have gained a better understanding of their financial management weaknesses and the impetus to resolve problems caused by those weaknesses. At the same time, agencies are slowly making progress in addressing their problems. However, while an increasing number of agencies are receiving "clean" audit opinions on their financial statements, the continued widespread noncompliance with FFMIA shows that there is still a long way to go to reach the end game—that is, having systems, processes, and controls that routinely generate reliable, useful, and timely information for managers and other decisionmakers.

As we testified in June,[5] many of the clean opinions were obtained through time-consuming, ad hoc programming and analysis of data produced by inadequate systems that are not integrated and often require significant adjustments. Such time-consuming procedures, which often represent "heroic efforts," prevent financial management staff from doing other financial-related work such as financial analyses, which could directly support strategic decision-making and ultimately improve overall business performance. In our *Executive Guide: Creating Value Through World-class Financial Management*,[6] we identified the success factors, practices, and outcomes associated with world-class financial management efforts. We found that many leading finance organizations have a goal to reduce the time spent on routine accounting activities, such as financial statement preparation, so that financial management staff can spend more time on activities such as business performance analysis or cost analysis.

[5] *Financial Management: Agencies Face Many Challenges in Meeting the Goals of the Federal Financial Management Improvement Act* (GAO/T-AIMD-00-178, June 6, 2000).

[6] GAO/AIMD-00-134, April 2000.

As required by FFMIA, the 19 agencies that determined their systems were not in compliance during fiscal year 1998[7] prepared remediation plans describing the actions they took or plan to take to overcome their problems and bring their systems into compliance.[8] We reviewed the 19 remediation plans and determined that while overall the plans had improved slightly over the fiscal year 1997 plans, some plans continued to lack specificity. The corrective actions in the plans were not always detailed, target dates were sometimes lacking, and information as to the type and amount of resources needed to implement the corrective actions was not included in several of the plans we reviewed.

The role of advisor established by FFMIA for the Office of Management and Budget (OMB), with respect to agency remediation plans, is important for ensuring that agencies prepare effective remediation plans that adequately address their serious financial management weaknesses. To support that effort, and because of the inadequacies we identified last year in agencies' fiscal year 1997 remediation plans, we recommended that OMB review agencies' plans for (1) detailed corrective actions that fully address reported problems, (2) inclusion of resource requirements, and (3) specific time frames needed to implement and resolve problems. OMB officials told us they have adopted a new approach for reviewing agencies' remediation plans, which is part of a comprehensive strategy for improving federal financial management. The new approach includes meetings with agency officials to discuss integrating the agency's plans for overhauling or replacing financial management systems with the agency's information technology capital planning processes. OMB has started meeting with agency officials; however, because this approach is new, we cannot comment on whether it will be successful in improving agencies' remediation plans and thus improving financial management in general.

[7]Auditors for 21 of the 24 CFO Act agencies reported that the agencies' systems did not substantially comply with FFMIA in fiscal year 1998. Two agencies did not submit remediation plans for fiscal year 1998 because agency management determined that their systems were in substantial compliance with FFMIA. While agency management acknowledged that the weaknesses identified by the auditors existed, they did not agree that the weaknesses resulted in lack of "substantial" compliance.

[8]Fiscal year 1998 remediation plans, addressing instances of noncompliance with FFMIA identified in financial statement audits covering fiscal year 1998, were due to the Office of Management and Budget (OMB) in October 1999. Remediation plans covering fiscal year 1999 instances of noncompliance are due to OMB in December 2000.

We also recommended last year that OMB work with the agencies to ensure that the agencies' financial statements are audited and issued by the March 1 statutory deadline. Officials from OMB, GAO, and the Department of the Treasury met with agencies to discuss, among other things, the timely preparation and audit of the agency financial statements. In addition, in large part due to the "heroic efforts" by many agencies, the number of agencies issuing their audited financial statements after March 1 decreased from 11 for fiscal year 1997 to 5 for fiscal year 1999. Having to perform such "heroic efforts" in order to issue financial statements by the statutory deadline indicates the need for continued OMB attention.

Bringing financial management systems into compliance with the requirements of FFMIA is a formidable challenge. Identifying the appropriate corrective actions for inclusion in agencies' remediation plans is just the first step toward that goal. Typically, the systems needs are complex and accordingly require well-considered and sophisticated efforts to implement. We have issued guidance to help agencies with such efforts, including guidance on making information technology investment decisions and improving information security management. Also, in order to aid in the selection of functional and cost-effective applications, the Joint Financial Management Improvement Program (JFMIP)[9] tests commercial off-the-shelf software for compliance with the current systems requirements. FFMIA compliance guidance is also contained in an exposure draft of a guide issued by JFMIP and the CFO Council and in checklists that we have published. And, finally, lessons learned from the government's successful Year 2000 efforts, including the importance of providing top management involvement and high-level leadership, can be applied to efforts to help improve agencies' financial management systems so that they can produce the reliable, useful, and timely information needed by management and other decisionmakers.

In commenting on a draft of this report, OMB expressed concerns regarding the seemingly "all or nothing" assessments of FFMIA compliance. Under OMB's current implementing guidance, agencies'

[9]JFMIP is a cooperative undertaking of OMB, the Department of the Treasury, the Office of Personnel Management (OPM), and GAO working with operating agencies to improve financial management practices throughout the government. The program was initiated in 1948 by the Secretary of the Treasury, the Director of the Bureau of the Budget (now OMB), and the Comptroller General and was given statutory authorization in the Budget and Accounting Procedures Act of 1950. The Civil Service Commission, now OPM, joined JFMIP in 1966.

systems are determined to either have substantially complied or not, without distinctions as to progress toward that goal. Also, OMB commented that the report was negative and did not give any credit for either progress made by agencies or current improvement efforts underway. We agree that it is important to measure progress toward achieving compliance with FFMIA to demonstrate that agencies' systems are moving steadily toward compliance with FFMIA's requirements. Our work, as well as that performed or directed by agency Inspectors General (IG) shows that agencies are making an effort, and we acknowledge that in the report. However, attaining the end goal of having reliable data on demand for day-to-day decision-making is a distant goal for many agencies. We plan to work with OMB as it contemplates various approaches to measuring and reporting progress in achieving compliance with FFMIA.

OMB also expressed concerns about the applicability of information security requirements to certain systems in assessing compliance with FFMIA. OMB's view is that for purposes of reviewing compliance with FFMIA, information security controls should only be considered for financial systems under the purview of the agency CFO, and not for mixed or enterprise systems, which OMB states must be addressed on an agencywide level. However, to the extent that financial and non-financial portions of mixed systems cannot be separated for purposes of information security controls, the mixed systems in their entirety are subject to FFMIA. Further, the applicability of FFMIA is not limited to systems within the influence of the agency CFO. Rather, FFMIA refers only to agency systems and vests ultimate responsibility in the agency head for determining whether agency systems comply with FFMIA requirements. Therefore, information security controls for not only financial systems, but also mixed systems in their entirety should be included in FFMIA reviews.

## Background

FFMIA and other financial management reform legislation, most notably the CFO Act, have underscored the importance of improving financial management across the federal government. The primary purpose of FFMIA is to ensure that agency financial management systems routinely provide reliable, useful, and timely financial information. With such information, government leaders will be better positioned to invest resources, reduce costs, oversee programs, and hold agency managers accountable for the way they run government programs. Financial management systems' compliance with federal financial management systems requirements, applicable accounting standards, and the SGL are the building blocks to help achieve these goals.

## Management Reform Framework

FFMIA is part of a series of management reform legislation passed by the Congress over the past two decades. This series of legislation started with the Federal Managers' Financial Integrity Act of 1982 (Financial Integrity Act), which the Congress passed to strengthen internal control and accounting systems throughout the federal government, among other purposes. However, as we reported in 1989,[10] 7 years after the Financial Integrity Act was passed, while agencies had achieved some success in identifying and correcting material internal control and accounting system weaknesses, their efforts to implement the Financial Integrity Act had not produced the results intended by the Congress. At that time, we also reported that the government did not have the internal control systems necessary to effectively operate its programs and safeguard its assets and that its accounting systems were antiquated and second-rate.

So, in the 1990s, the Congress passed additional management reform legislation to improve the general and financial management of the federal government. The combination of reforms ushered in by (1) the CFO Act of 1990, (2) the Government Management and Reform Act of 1994, (3) FFMIA, (4) the Government Performance and Results Act of 1993, and (5) the Clinger-Cohen Act of 1996, if successfully implemented, provides a basis for improving accountability over government operations and routinely producing sound cost and operating performance information, thereby making it possible to better assess and improve the government's financial condition and operating performance. In addition, in November 1999 we updated our *Standards for Internal Control in the Federal Government,*[11] which is issued pursuant to the Financial Integrity Act to help agency managers implement effective internal control, an integral part of improving financial management systems.

## Financial Management Systems Requirements

The financial management systems policies and standards prescribed for executive agencies to follow in developing, operating, evaluating, and reporting on financial management systems are defined in OMB Circular A-127, *Financial Management Systems.* Circular A-127 references the series of publications, entitled Federal Financial Management Systems Requirements (FFMSR), issued by JFMIP as the primary source of

[10] *Financial Integrity Act: Inadequate Controls Result in Ineffective Federal Programs and Billions in Losses* (GAO/AFMD-90-10, November 28, 1989).

[11] GAO/AIMD-00-21.3.1, November 1999.

governmentwide requirements for financial management systems. JFMIP systems requirements, among other things, provide a framework for establishing integrated financial management systems to support program and financial managers. These requirements documents were first issued in the early 1990s, and several have been updated since then. Table 1 lists the current publications in the FFMSR series and their issue dates.

**Table 1: Publications in the Federal Financial Management System Requirements Series**

| | FFMSR document | Issue date |
|---|---|---|
| FFMSR-0 | *Framework for Federal Financial Management Systems* | January 1995 |
| FFMSR-7 | *Inventory System Requirements* | June 1995 |
| FFMSR-8 | *Managerial Cost Accounting System Requirements* | February 1998 |
| JFMIP-SR-99-4 | *Core Financial System Requirements* | February 1999 |
| JFMIP-SR-99-5 | *Human Resources & Payroll Systems Requirements* | April 1999 |
| JFMIP-SR-99-8 | *Direct Loan System Requirements* | June 1999 |
| JFMIP-SR-99-9 | *Travel System Requirements* | July 1999 |
| JFMIP-SR-99-14 | *Seized Property and Forfeited Asset Systems Requirements* | December 1999 |
| JFMIP-SR-00-01 | *Guaranteed Loan System Requirements* | March 2000 |
| JFMIP-SR-00-3 | *Grant Financial System Requirements* | June 2000 |

JFMIP is also developing systems requirements where none previously existed. JFMIP issued an exposure draft on *Property Management System Requirements* in April 2000. A large number of responses and comments were received, and as a result, a second exposure draft was issued in July 2000. Also, efforts are underway to develop system requirements documents for benefit programs and acquisition systems.

## Federal Accounting Standards

Federal accounting standards, which agency CFOs use in preparing financial statements and in developing financial management systems, are developed by the Federal Accounting Standards Advisory Board (FASAB).[12] FASAB develops accounting standards after considering the financial and budgetary information needs of the Congress, executive agencies, and other users of federal financial information and comments from the public. FASAB forwards the standards to the three principals—the Comptroller General of the United States (Comptroller General), the Secretary of the Treasury, and the Director of OMB—for a 90-day review. If there are no objections during the review period, the standards are considered final and FASAB publishes them on its Web site and in print.

The American Institute of Certified Public Accountants now recognizes the federal accounting standards developed by FASAB as being generally accepted accounting principles for the federal government. This recognition enhances the acceptability of the standards, which form the foundation for preparing consistent and meaningful financial statements both for individual agencies and the government as a whole.

Currently, there are 18 statements of federal financial accounting standards (SFFAS) and 3 statements of federal financial accounting concepts (SFFAC).[13] The concepts and standards are the basis for OMB's guidance to agencies on the form and content of their financial statements and the government's consolidated financial statements. Table 2 lists the concepts, standards, and interpretations[14] along with their respective effective dates.

[12]In October 1990, the Secretary of the Treasury, the Director of OMB, and the Comptroller General established FASAB to recommend a set of generally accepted accounting standards for the federal government.

[13]Accounting standards are authoritative statements of how particular types of transactions and other events should be reflected in financial statements. SFFACs explain the objectives and ideas upon which FASAB develops the standards.

[14]Occasionally, FASAB clarifies existing federal accounting standards by providing interpretations. An interpretation is a document of narrow scope that provides clarifications of original meaning, additional definitions, or other guidance pertaining to an existing federal accounting standard.

**Table 2: Statements of Federal Financial Accounting Concepts, Statements of Federal Financial Accounting Standards, and Interpretations**

| **Concepts** | |
|---|---|
| SFFAC No. 1 *Objectives of Federal Financial Reporting* | |
| SFFAC No. 2 *Entity and Display* | |
| SFFAC No. 3 *Management's Discussion and Analysis* | |
| **Standards** | **Effective for fiscal year**[a] |
| SFFAS No. 1 *Accounting for Selected Assets and Liabilities* | 1994 |
| SFFAS No. 2 *Accounting for Direct Loans and Loan Guarantees* | 1994 |
| SFFAS No. 3 *Accounting for Inventory and Related Property* | 1994 |
| SFFAS No. 4 *Managerial Cost Accounting Concepts and Standards* | 1998 |
| SFFAS No. 5 *Accounting for Liabilities of the Federal Government* | 1997 |
| SFFAS No. 6 *Accounting for Property, Plant, and Equipment* | 1998 |
| SFFAS No. 7 *Accounting for Revenue and Other Financing Sources* | 1998 |
| SFFAS No. 8 *Supplementary Stewardship Reporting* | 1998 |
| SFFAS No. 9 *Deferral of the Effective Date of Managerial Cost Accounting Standards for the Federal Government in SFFAS No. 4* | 1998 |
| SFFAS No. 10 *Accounting for Internal Use Software* | 2001 |
| SFFAS No. 11 *Amendments to Accounting for Property, Plant, and Equipment—Definitional Changes* | 1999 |
| SFFAS No. 12 *Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS No. 5, Accounting for Liabilities of the Federal Government* | 1998 |
| SFFAS No. 13 *Deferral of Paragraph 65-2—Material Revenue-Related Transactions Disclosures* | 1999 |
| SFFAS No. 14 *Amendments to Deferred Maintenance Reporting* | 1999 |
| SFFAS No. 15 *Management's Discussion and Analysis* | 2000 |
| SFFAS No. 16 *Amendments to Accounting for Property, Plant, and Equipment* | 2000 |
| SFFAS No. 17 *Accounting for Social Insurance* | 2000 |
| SFFAS No. 18 *Amendments to Accounting Standards for Direct Loans and Loan Guarantees in SFFAS No. 2* | 2001 |
| **Interpretations** | |
| No. 1 *Reporting on Indian Trust Funds* | |
| No. 2 *Accounting for Treasury Judgment Fund Transactions* | |
| No. 3 *Measurement Date for Pension and Retirement Health Care Liabilities* | |
| No. 4 *Accounting for Pension Payments in Excess of Pension Expense* | |
| No. 5 *Recognition by Recipient Entities of Receivable Nonexchange Revenue* | |

[a]Effective dates do not apply to Statements of Federal Financial Accounting Concepts and Interpretations.

FASAB's Accounting and Auditing Policy Committee (AAPC)[15] assists in resolving issues related to the implementation of accounting standards. AAPC's efforts result in guidance for preparers and auditors of federal financial statements in connection with implementation of accounting standards and the reporting and auditing requirements contained in OMB's *Form and Content Bulletin* and *Audit Bulletin.* To date, AAPC has released four technical releases (TR), which are listed in table 3 along with their release dates.

**Table 3: AAPC Technical Releases**

| Technical release | AAPC release date |
|---|---|
| TR-1 *Audit Legal Letter Guidance* | March 1, 1998 |
| TR-2 *Environmental Liabilities Guidance* | March 15, 1998 |
| TR-3 *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* | July 31, 1999 |
| TR-4 *Reporting on Non-Valued Seized and Forfeited Property* | July 31, 1999 |

## Standard General Ledger

The SGL was established by an interagency task force through the direction of OMB and mandated for use by OMB and Treasury regulations in 1986. The SGL promotes consistency in financial transaction processing and reporting by providing a uniform chart of accounts and pro forma transactions used to standardize federal agencies' financial information accumulation and processing, enhance financial control, and support budget and external reporting, including financial statement preparation. The SGL is intended to improve data stewardship throughout the government, enabling consistent reporting at all levels within the agencies and providing comparable data and financial analysis at the governmentwide level.[16]

[15]In 1997, FASAB, in conjunction with OMB, Treasury, GAO, the CFO Council, and the President's Council on Integrity and Efficiency, established AAPC to assist the federal government in improving financial reporting.

[16]SGL guidance is published in the *Treasury Financial Manual.* Treasury's Financial Management Service is responsible for maintaining the SGL and answering agency inquiries.

## Remediation Plans

FFMIA requires an agency head to determine, based on a review of the auditor's report on the agency's financial statements and any other relevant information, whether the agency's financial management systems substantially comply with the act. The agency head is required to make this determination no later than 120 days after (1) the receipt of the auditor's report or (2) the last day of the fiscal year following the year covered by the audit, whichever comes first. If the agency head disagrees with the auditor's determination that the systems do not substantially comply, the Director of OMB is to review the agency head's determination and report to the Congress. If the agency head agrees that the systems do not substantially comply, FFMIA requires that the agency head, in consultation with the Director of OMB, establish a remediation plan to bring the systems into substantial compliance with FFMIA's requirements.

According to FFMIA, remediation plans are to include corrective actions, intermediate target dates, and resources necessary to bring the financial management systems into substantial compliance with FFMIA's requirements within 3 years of the date the agency head's noncompliance determination is made. If, with the concurrence of the Director of OMB, the agency head determines that substantial compliance cannot be reached within 3 years, the remediation plan must specify the most feasible date by which the agency's systems will achieve compliance and designate an official responsible for effecting the necessary corrective actions.

In accordance with OMB guidance contained in Circular A-11, *Preparing and Submitting Budget Estimates*, effective July 12, 1999, agencies are to include their remediation plans in their annual budget submissions due to OMB in October. The guidance requires that the plans include corrective actions, resources needed, and interim target dates to bring the financial management systems into substantial compliance within 3 years of the date of the agencies' determination that their systems are not in substantial compliance.[17]

[17]The most current revision of Circular A-11, effective July 19, 2000, requires that in addition to corrective actions, resources, and target dates, agencies also identify responsible officials in their remediation plans. The guidance changes the due date for budget submission documents due in 2000 to December rather than October because of the presidential transition.

## Scope and Methodology

We reviewed fiscal year 1999 audit reports for the 24 CFO Act agencies to determine (1) which agencies had systems that their auditors found to be noncompliant with FFMIA's requirements, (2) reasons why the systems were found to be noncompliant, and (3) whether the audit reports were issued by the March 1 statutory deadline. Our review included determining where "heroic efforts" were used to meet the deadline. We interviewed agency management and auditors at several CFO Act agencies to obtain their views on FFMIA implementation, including what factors management considered in determining whether their agencies' systems complied.

We reviewed OMB's guidance for FFMIA and interviewed OMB officials responsible for FFMIA issues. Specifically, we reviewed the guidance for preparing remediation plans for fiscal year 1998 contained in OMB Circular A-11, *Preparing and Submitting Budget Estimates.* We reviewed agencies' fiscal year 1998 remediation plans to determine if they contained the required elements and if the corrective actions in the plans would resolve agencies' systems problems. Fiscal year 1999 remediation plans are not due to OMB, and therefore will not be available, until December 2000. We compared the fiscal year 1998 remediation plans to those for fiscal year 1997 to determine if they had improved. We interviewed OMB officials and staff to determine what actions OMB has taken regarding agencies' remediation plans. We also reviewed a draft of the revised guidance in OMB Bulletin 98-08, *Audit Requirements for Federal Financial Statements.*

We reviewed applicable federal accounting standards and systems requirements documents. We made inquiries of FASAB and JFMIP staff to determine recent developments in their respective efforts to develop accounting standards and issue new systems requirements documents.

We conducted our work from February through August 2000 at the 24 CFO Act agencies and OMB in Washington, D.C., in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the Director of OMB or his designee. The Deputy Controller of OMB provided us with written comments. These comments are discussed in the "Agency Comments and Our Evaluation" section and are reprinted in appendix I.

## Fiscal Year 1999 Audit Results Indicate Progress But Serious Problems Remain

Agencies have a better understanding of their financial management weaknesses and are slowly making progress in addressing their problems. However, while an increasing number of agencies are issuing their audited financial statements on time and receiving unqualified (clean) audit opinions, financial management systems of the vast majority of CFO Act agencies do not yet comply with FFMIA's requirements and, therefore, fall short of the CFO Act and FFMIA goal to provide reliable, useful, and timely information to assist in day-to-day management. This continuing widespread noncompliance with FFMIA is indicative of the overall long-standing poor condition of agency financial systems.

Auditors for 21 of the 24 CFO Act agencies reported that for fiscal year 1999, the agencies' systems still did not comply substantially with federal financial systems requirements, federal accounting standards, or the SGL.[18] Auditors for three agencies—the Department of Energy,[19] the National Aeronautics and Space Administration, and the National Science Foundation—reported the agencies' systems to be in substantial compliance. These FFMIA compliance results were similar to those for fiscal years 1997 and 1998.

[18]Management of 3 of the 21 agencies—the Federal Emergency Management Agency, the Social Security Administration, and the Office of Personnel Management (OPM)—disagreed with their auditors' determinations that their agencies' systems did not comply substantially with FFMIA's requirements. Management of these three agencies acknowledged that the weaknesses identified by the auditors exist but did not agree that the weaknesses caused "substantial noncompliance." (In the case of OPM, management determined that the systems for the Retirement, Health Benefits Insurance, and Life Insurance programs did comply substantially with FFMIA. For the Revolving Fund and Salaries and Expenses, OPM management agreed with its auditors that the systems did not comply substantially with FFMIA.)

[19]According to OMB guidance in OMB Bulletin 98-08, material weaknesses in internal controls that affect an agency's ability to prepare auditable financial statements and related disclosures are an indication of noncompliance with FFMIA. In its fiscal year 1999 *Report on Internal Controls*, the Department of Energy's IG reported a material weakness related to the Western Area Power Administration's new financial management system. The report states, "While the Department's systems as a whole substantially comply with FFMIA, the new financial management system implemented by Western was not in compliance with the FFMIA requirements as of September 30, 1999. . . . Thus, Western was unable to adequately track and report on budget execution and meet external reporting requirements, including preparation of financial statements."

Fifteen of the 24 CFO Act agencies received unqualified audit opinions on their financial statements for fiscal year 1999, up from 12 in fiscal year 1998 and 11 in fiscal year 1997. Yet, FFMIA noncompliance has been fairly consistent since fiscal year 1997 when the systems of 20 of the 24 CFO Act agencies were reported to be noncompliant.[20] Auditors for 12 of the 15 agencies that received unqualified opinions reported that the agencies' financial systems did not comply substantially with FFMIA's requirements in fiscal year 1999. In many cases, these agencies spent considerable resources and often performed "heroic efforts" to obtain a clean opinion because their financial statements could not be produced from their financial systems.

Not only has the number of clean opinions increased, the number of agencies issuing their audited financial statements on time has also increased. To emphasize the importance of timely preparation and audit of agency financial statements, officials from OMB, GAO, and the Department of the Treasury held meetings with cognizant agency officials. For fiscal year 1999, 5 of the 24 CFO Act agencies issued their audited statements after the statutory due date of March 1, compared to fiscal year 1997, when 11 agencies were late issuing their audited financial statements. However, as was the case in obtaining clean opinions, many agencies relied on "heroic efforts" just to meet the statutory due date. Having to perform such efforts indicates the need for continued OMB attention.

Table 4 summarizes the auditors' FFMIA determinations and financial statement opinions for fiscal year 1999 and highlights the 12 agencies that received clean audit opinions despite their systems problems.

[20]In fiscal year 1998, the systems of 21 of the 24 CFO Act agencies were reported to be noncompliant.

Table 4: Auditors' FFMIA Determinations and Financial Statement Opinions for Fiscal Year 1999

| | Auditors' determination of substantial compliance | | Areas of reported substantial noncompliance | | | Audit opinion | | |
|---|---|---|---|---|---|---|---|---|
| Agency | Yes | No | Systems requirements | Accounting standards | SGL | Unqualified | Qualified | Disclaimer |
| Department of Agriculture | | √ | √ | √ | √ | | | √ |
| Department of Commerce | | √ | √ | | √ | √ | | |
| Department of Defense | | √ | √ | √ | √ | | | √ |
| Department of Education | | √ | √ | √ | | | [a] | |
| Department of Energy | √ | | | | | √ | | |
| Department of Health and Human Services | | √ | √ | | | √ | | |
| Department of Housing and Urban Development | | √ | √ | √ | √ | | | √ |
| Department of the Interior | | √ | √ | √ | | √ | | |
| Department of Justice | | √ | √ | √ | √ | | √ | |
| Department of Labor | | √ | √ | √ | √ | √ | | |
| Department of State | | √ | √ | | | √ | | |
| Department of Transportation | | √ | √ | √ | √ | √ | | |
| Department of the Treasury | | √ | √ | √ | √ | | √ | |
| Department of Veterans Affairs | | √ | √ | √ | √ | √ | | |
| Agency for International Development | | √ | √ | √ | √ | | | √ |
| Environmental Protection Agency | | √ | √ | √ | √ | | √ | |
| Federal Emergency Management Agency | | √ | √ | | | √ | | |
| General Services Administration | | √ | √ | | | √ | | |

(Continued From Previous Page)

| | Auditors' determination of substantial compliance | | Areas of reported substantial noncompliance | | | Audit opinion | | |
|---|---|---|---|---|---|---|---|---|
| **Agency** | **Yes** | **No** | **Systems requirements** | **Accounting standards** | **SGL** | **Unqualified** | **Qualified** | **Disclaimer** |
| National Aeronautics and Space Administration | √ | | | | | √ | | |
| National Science Foundation | √ | | | | | √ | | |
| Nuclear Regulatory Commission | | √ | √ | √ | √ | √ | | |
| Office of Personnel Management | | √ | √ | √ | √ | | | b |
| Small Business Administration | | √ | √ | √ | √ | √ | | |
| Social Security Administration | | √ | √ | | | √ | | |
| **Total** | **3** | **21** | **21** | **15** | **14** | **15** | **4** | **5** |

= Auditors gave the agency's financial statements an unqualified audit opinion, but reported that the agency's systems did not comply substantially with FFMIA's requirements.

Note: Management of 21 of the 24 agencies agreed with their auditors' FFMIA compliance determinations. Management of the remaining three agencies—the Federal Management Emergency Agency, the Social Security Administration, and the Office of Personnel Management—did not agree that their systems were not in substantial compliance. See footnote 18.

[a] Education received a disclaimer of opinion on its Statement of Financing and qualified opinions on its other financial statements.

[b] The Office of Personnel Management (OPM) does not prepare agencywide financial statements. For fiscal year 1999, OPM received disclaimers of opinion on its financial statements for Revolving Fund and Salaries and Expenses and unqualified opinions on the financial statements for the Retirement, Health Benefits Insurance, and Life Insurance Programs.

Source: GAO analysis of agency audit reports for fiscal year 1999.

Financial statement audit results are key indicators of the quality of agency financial data at year-end and provide an annual public scorecard on accountability. Agencies are to be commended for receiving unqualified audit opinions. At the same time, a clean audit opinion is not an end in itself. A clean audit opinion indicates to financial statement users only that the information is fairly presented as of the date of the financial statements—the last day of the fiscal year. However, financial statement

users generally do not get this information until 5 months after the close of the fiscal year—around March 1, the statutory deadline—which is when most agencies issue their financial statements. As illustrated below, this time lag often results from the numerous adjustments and other "heroic efforts" needed to prepare these statements. Although a clean opinion indicates that year-end financial information is fairly presented, it provides no assurance about the effectiveness and efficiency of financial systems used to prepare the statements or whether use of the same or other information generated by the financial systems for management use throughout the year would be appropriate. The results shown in table 4 indicate that although auditors reported that the financial statements of 15 of the 24 CFO Act agencies were fairly presented and reliable at the end of the fiscal year, as we discuss later in this report, the financial systems of 21 of the 24 agencies have weaknesses, some of which are so serious that they are not able to routinely provide reliable, useful, and timely information on an ongoing basis.

In order to receive an unqualified opinion, many agencies whose financial management systems did not comply with FFMIA had to rely on "heroic efforts" consisting of time-consuming, ad hoc programming and analysis of data produced by inadequate systems that are not integrated or routinely reconciled and often require significant audit adjustments. For example, the Department of Transportation (DOT) received its first unqualified opinion on its fiscal year 1999 departmentwide financial statements. However, like several other agencies, despite the clean opinion, DOT's IG reported that DOT's systems did not comply substantially with FFMIA.[21] DOT's existing core accounting system—designed to be the primary system for producing financial information and financial statements—was not the primary source of information used to prepare the financial statements. Because the core system did not provide the necessary data, DOT made about 800 adjusting entries totaling $36 billion. Also, according to the IG, the Federal Aviation Administration's property systems were not designed as an integrated system to accurately account for property costs.[22] Therefore, DOT hired additional contractors, detailed employees, and used extensive overtime and compensatory time to provide sufficient evidence to support the amounts of property, plant, and equipment shown on its

[21] *Office of Inspector General Audit Report, Fiscal Year 1999 Consolidated Financial Statements, Department of Transportation*, Report No. FE-2000-062, March 8, 2000.

[22] *Fiscal Year 1999 Financial Statements, Federal Aviation Administration*, Report No. FE-2000-060, February 29, 2000.

financial statements. The IG reported that these manual and labor-intensive methods are expensive; prone to errors, mistakes, and inaccuracies; and cannot be sustained.

As we discuss below, one of the main problems agencies face is the lack of an integrated financial management system. Having an effective, integrated financial management system that can produce financial statements in a timely manner prevents the need for time-consuming and costly procedures. In our *Executive Guide: Creating Value Through World-class Financial Management*, we identified the success factors, practices, and outcomes associated with world-class financial management efforts. We found that many leading finance organizations have a goal to reduce the time spent on routine accounting activities, such as financial statement preparation, so that financial management staff can spend more time on activities such as business performance analysis or cost analysis.

## Reasons for Noncompliance

Based on our review of fiscal year 1999 audit reports for the 21 agencies whose financial management systems were reported to be noncompliant, we identified five primary reasons cited by the auditors:

- nonintegrated financial management systems,
- inadequate reconciliation procedures,
- noncompliance with the SGL,
- lack of adherence to federal accounting standards, and
- weak security over information systems.

Table 5 shows the 21 agencies with noncompliant systems and the problems relevant to FFMIA that were reported by their auditors.[23] Auditors reported these problems among the weaknesses identified during the audits; however, the auditors may not have reported the problems as specific reasons for why they concluded that the agencies' systems did not comply with FFMIA. Further, the weaknesses reported by auditors ranged from serious, pervasive systems problems to less serious problems that may affect one aspect of an agency's accounting operation. We included all weaknesses relevant to FFMIA identified by the auditors because such

[23]Based on further review of agency audit reports, we have updated information in this table, which first appeared in our June testimony on FFMIA, *Financial Management: Agencies Face Many Challenges in Meeting the Goals of the Federal Financial Management Improvement Act* (GAO/T-AIMD-00-178, June 6, 2000).

problems must be resolved in order for the agencies' systems to generate the reliable, useful, and timely information needed by decisionmakers.

**Table 5: Problems Reported by Auditors in Fiscal Year 1999**

| Agency | Nonintegrated financial management systems | Inadequate reconciliation procedures | Noncompliance with the SGL | Lack of adherence to federal accounting standards | Weak security over information systems |
|---|---|---|---|---|---|
| Department of Agriculture | √ | √ | √ | √ | √ |
| Department of Commerce | √ | √ | √ | | √ |
| Department of Defense | √ | √ | √ | √ | √ |
| Department of Education | √ | √ | | √ | √ |
| Department of Health and Human Services | √ | √ | | | √ |
| Department of Housing and Urban Development | √ | √ | √ | √ | √ |
| Department of the Interior | | | | √ | √ |
| Department of Justice | √ | √ | √ | √ | √ |
| Department of Labor | √ | √ | √ | √ | √ |
| Department of State | √ | √ | | | √ |
| Department of Transportation | √ | | √ | √ | √ |
| Department of the Treasury | √ | √ | √ | √ | √ |
| Department of Veterans Affairs | √ | √ | √ | √ | √ |
| Agency for International Development | √ | √ | √ | √ | √ |
| Environmental Protection Agency | | √ | √ | √ | √ |
| Federal Emergency Management Agency | √ | √ | | | √ |
| General Services Administration | | | | | √ |
| Nuclear Regulatory Commission | | | √ | √ | √ |
| Office of Personnel Management | | √ | √ | √ | √ |
| Small Business Administration | √ | | √ | √ | √ |
| Social Security Administration | | | | | √ |
| **Totals** | **15** | **15** | **14** | **15** | **21** |

Source: GAO analysis of agency audit reports for fiscal year 1999. We did not independently verify or test the data in the agency audit reports.

To understand how these weaknesses affect agencies' financial management efforts and to bring about any lasting improvements, it is important to understand what these weaknesses mean and how they affect the government's operations. The following sections describe the five types of weaknesses and provide examples identified by the agencies' auditors.

## Nonintegrated Financial Management Systems

One of the federal financial systems requirements is that agencies' financial management systems be integrated.[24] According to the CFO Act, agencies are to develop and maintain an integrated accounting and financial management system that complies with federal systems requirements and provides for (1) complete, reliable, consistent, and timely information that responds to the financial information needs of the agency and facilitates the systematic measurement of performance, (2) the development and reporting of cost information, and (3) the integration of accounting, budgeting, and program information. In this regard, OMB Circular A-127, *Financial Management Systems*, requires agencies to establish and maintain an integrated financial management system that conforms with JFMIP's functional requirements.

When agencies do not have an integrated financial management system—which includes a budget system and program systems that maintain financial information, such as logistics, personnel, and acquisition systems—they are often forced to rely on ad hoc programming, analysis, or actions—such as taking physical inventories solely for the purpose of determining what assets they have on hand rather than verifying amounts recorded in the financial system—to satisfy financial reporting and analysis responsibilities. In these situations, agencies must expend major effort and resources, and some agencies rely heavily on external consultants to develop information that their systems should be able to provide on a daily or recurring basis. In addition, opportunities for errors are significantly increased when agencies' systems are not integrated.

Modern, integrated financial systems rely on transaction-based entries to update all relevant accounts, be they for budgetary control, proprietary accounting objectives, or program management. In these modern,

[24]Federal financial system requirements define an integrated financial system as one that coordinates a number of previously unconnected functions to improve overall efficiency and control. Characteristics of such a system include (1) standard data classifications for recording financial events, (2) common processes for processing similar transactions, (3) consistent internal controls over data entry, transaction processing, and reporting, and (4) a system design that eliminates unnecessary duplication of transaction entry.

integrated systems, financial data are carried in a common format, and the effects of financial transactions in one application are accurately transmitted to other affected applications. Accordingly, aside from the timeliness in recording transactions, the use of integrated systems largely negates the risk of out-of-balance situations and data-entry errors. Thus, agencies can have at their disposal information that can quickly provide year-to-date balances, mitigate the need for extensive reconciliation procedures, and more important, can be used for analysis throughout the year.

A continuing, serious problem is that agencies lack modern, integrated financial management systems. As shown in table 5, auditors for 15 of the 21 agencies with noncompliant systems reported this as a problem. For example, as we testified in February 2000,[25] the Internal Revenue Service (IRS) had to focus substantial efforts on developing compensating processes to work around its serious systems and internal control weaknesses to derive year-end balances for its financial statements.[26] Because IRS' aging financial management systems have not been redesigned to meet current systems requirements and financial reporting standards, IRS' approach to preparing financial statements relied heavily on costly, time-consuming processes; statistical projections; and external consultants to derive year-end balances. For instance, IRS continues to have pervasive problems in managing and reporting unpaid assessments.[27] IRS does not have a subsidiary ledger that tracks and accumulates unpaid assessments and their status on an ongoing basis. The absence of the subsidiary ledger adversely affects IRS' ability to effectively manage and accurately report these assessments. Typically, an entity's accounts receivable balances would be supported by detailed records, listings, or a subsidiary ledger of individual amounts, which are all part of an integrated financial management system. To compensate for the lack of an unpaid assessment subsidiary ledger, IRS uses ad hoc programs that extract data

[25] *Internal Revenue Service: Results of Fiscal Year 1999 Financial Statement Audit* (GAO/T-AIMD-00-104, February 29, 2000).

[26] The Department of the Treasury is 1 of the 21 agencies whose systems were reported as noncompliant. The noncompliance was due, among other things, to IRS' systems problems.

[27] Unpaid assessments consist of amounts for which (1) IRS can support the existence of a receivable through taxpayer agreement or a favorable court ruling (federal taxes receivable), (2) neither the taxpayer nor the court has affirmed that the amounts are owed (compliance assessments), and (3) IRS does not expect further collections due to factors such as the taxpayer's death, bankruptcy, or insolvency (write-offs).

from the tax master files—its database of taxpayer information. However, as in past years, the results still required significant adjustments totaling tens of billions of dollars before taxes receivable could be reliably reported on the balance sheet. IRS' top management recognizes this and has demonstrated a strong commitment to developing an integrated system as part of tax systems modernization.

## Inadequate Reconciliation Procedures

A reconciliation process, even if performed manually, is a valuable part of a sound financial management system. In fact, the less integrated the financial management system, the greater the need for adequate reconciliations because data for the same transaction may be separately entered in multiple systems. Reconciliation of records from the multiple systems would ensure that transaction data were entered correctly in each one. Reconciliation is also an important control for establishing agreement between two sets of independently maintained but related records because it helps to ensure the integrity of the underlying accounting data supporting the financial statements. For example, in a private company, the ledger account for Cash in Bank is reconciled with the bank statement received from the bank, and the home office record of shipments to a branch office is reconciled with the record of receipts maintained by the branch. Our recently updated *Standards for Internal Control in the Federal Government* highlight reconciliation as a key control activity.

As shown in table 5, auditors for 15 of the 21 agencies with noncompliant systems reported that the agencies had reconciliation problems, including difficulty reconciling their Fund Balance with Treasury accounts[28] with the Department of the Treasury's records. Treasury policy requires agencies to reconcile their accounting records with Treasury records monthly, which is comparable to individuals reconciling their checkbooks to their monthly bank statements. However, such reconciliations are not being routinely performed.

[28]Agencies record their budget spending authorizations in their Fund Balance with Treasury accounts. Agencies increase or decrease these accounts as they collect or disburse funds.

For example, the Department of Education's auditors reported that Education did not perform proper or timely reconciliations of its financial accounting records throughout fiscal year 1999.[29] And, at fiscal year-end, the balance in Education's Fund Balance with Treasury account varied considerably from the related balance reported by Treasury. In order to make the account balances agree, Education made an unsupported adjustment of a net amount of about $244 million to its Fund Balance with Treasury account. This means that Education simply changed its records to agree with Treasury balances without adequately researching the causes and reconciling the differences. Because Education had not been performing periodic reconciliations and discerning reasons for differences on an ongoing basis, it could not determine which records, if any, were correct and, accordingly, relied on Treasury's records, not its own.

## Noncompliance With the SGL

Implementing the SGL at the transaction level is one of the major requirements of FFMIA. However, as shown in table 5, auditors for 14 of the 21 agencies with noncompliant systems reported that the agencies' systems did not comply with SGL requirements. By not implementing the SGL, agencies are challenged to provide consistent financial information across their component entities and functions. The effect of such differences is further compounded at the governmentwide level and contributed to our disclaimer of opinion on the U.S. government's consolidated financial reports for fiscal years 1997, 1998, and 1999 because the government could not ensure that the information in its financial statements was properly and consistently compiled.[30]

[29] *The U.S. Department of Education, Audited Financial Statements, Year Ended September 30, 1999, Report of Independent Auditors*, Ernst & Young LLP, February 2, 2000. Also see *Financial Management: Financial Management Weaknesses at the Department of Education* (GAO/T-AIMD-00-50, December 6, 1999), *Financial Management: Education Faces Challenges in Achieving Financial Management Reform* (GAO/T-AIMD-00-106, March 1, 2000), and *Financial Management: Education's Financial Management Problems Persist* (GAO/T-AIMD-00-180, May 24, 2000).

[30] *Financial Audit: 1997 Consolidated Financial Statements of the United States Government* (GAO/AIMD-98-127, March 31, 1998), *Financial Audit: 1998 Financial Report of the United States Government* (GAO/AIMD-99-130, March 31, 1999), *and Financial Audit: 1999 Financial Report of the United States Government* (GAO/AIMD-00-131, March 31, 2000).

In March, a Treasury official testified that the federal government needs to increase the use of the SGL in agency accounting systems to improve the reliability and accuracy of financial information.[31] The official stated

"Our ability to prepare the consolidated financial report using SGL data so that it is consistent with data in agency statements is hampered by the fact that a large number of agencies do not properly use the SGL. In many instances, agencies cannot adequately produce and send the SGL data to Treasury because their systems do not record accounting events using the SGL at the transaction level as mandated by the FFMIA. This results in additional workload and processes to ensure that amounts are recorded in the proper accounts. Additionally, this frustrates attempts to maximize efficiency through the creation of automated analytical tools."

For example, the Agency for International Development's (AID) IG reported that AID did not record accounts receivable in accordance with the SGL at the transaction level.[32] AID relied on data calls[33] to obtain the total amount of outstanding accounts receivable because it did not have integrated financial management systems. These data calls were posted to the general ledger at the summary level as opposed to the transaction level as required. According to the IG, by using data calls to determine outstanding accounts receivable, AID is at risk that the information obtained is not accurate or complete.

## Lack of Adherence to Federal Accounting Standards

One of FFMIA's requirements is that agencies' financial management systems comply with applicable federal accounting standards. As shown in table 5, auditors for 15 of the 21 agencies with noncompliant systems reported that the agencies had problems complying with one or more of these standards. Some agencies have experienced difficulty implementing the standards because their financial management systems are not capable of producing the financial data needed. FASAB continues to deliberate on new and emerging accounting issues that could result in its issuing additional standards; therefore, agencies' systems also must be able to accommodate any standards that may be issued in the future.

[31] *Are the Financial Records of the Federal Government Reliable?* Testimony of Donald V. Hammond, Fiscal Assistant Secretary, Department of the Treasury, March 31, 2000.

[32] *Reports on USAID's Consolidated Financial Statements, Internal Controls, and Compliance for Fiscal Year 1999* (Report No. 0-000-00-006-F, February 18, 2000).

[33] Data calls is a term used to describe the process of requesting that various offices provide outstanding balances as of year-end. The resulting reports are prepared from data contained outside the formal accounting system.

For example, the processes and procedures used by the Department of Agriculture's (USDA) lending agencies to estimate and reestimate loan subsidy costs do not comply with SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*. SFFAS No. 2, which generally mirrors the requirements of the Federal Credit Reform Act of 1990, contains guidance for agencies to estimate the cost of direct and guaranteed loan programs when preparing their annual budgets. The data used for these budgetary estimates are generally reestimated after the fiscal year-end to reflect any changes in actual loan performance since the budget was prepared. SFFAS No. 2 also contains guidance for recording the reestimated cost of direct loans and the reestimated liability for loan guarantees in the agency's financial statements. Further, SFFAS No. 2 states that agencies should use historical experience as a primary factor upon which to develop estimates of future loan performance.

We testified in March that USDA was unable to develop reasonable estimates of the costs of its loan programs because its financial systems were not able to capture the data needed to make these estimates.[34] Also, USDA lacked historical information on borrower behavior, such as how many borrowers will pay early, pay late, or default on their loans and at what point in time. As a result, the Congress and other decisionmakers do not know whether they can rely on the agency-reported costs of USDA's loan programs included in the agency's budget request and in its annual financial statements—estimated to be in excess of $27.3 billion as of September 30, 1999—for programmatic and budgetary decision-making. Cost estimates based on unreliable data can affect the availability of credit programs to potential borrowers because changes in these estimates can affect the number and amount of loans and guarantees that can be made.

[34] *Financial Management: USDA Faces Major Financial Management Challenges* (GAO/T-AIMD-00-115, March 21, 2000).

## Weak Security Over Information Systems

Information security weaknesses are one of the primary causes of systems' noncompliance with FFMIA and a huge concern for federal agencies and the general public. Even if agencies' systems were integrated, complied with the SGL, and stringently adhered to federal accounting standards, without strong information security controls, there is still the risk that the systems would not be able to provide reliable, useful, and timely data. As we testified last year and earlier this year, hacker attacks have shown just how quickly computer viruses—such as Melissa and ILOVEYOU—can spread and just how vulnerable federal information systems are to such computer attacks.[35] These hacker attacks have clearly highlighted the urgent and serious need for stronger agency and governmentwide protection over agency data.

As shown in table 5, auditors for all 21 agencies with noncompliant systems reported information security weaknesses as a problem in fiscal year 1999. Further, our analyses as well as those of agency IGs show that virtually all of the largest federal agencies have significant computer security weaknesses.[36] These weaknesses, which we designated as a governmentwide high-risk area in 1997 and 1999,[37] are placing enormous amounts of federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. Our recent update to the federal government's internal control standards highlights the need for adequate control over automated information systems to ensure protection from inappropriate access and unauthorized use by hackers and other trespassers or inappropriate use by agency personnel.

The most serious reported information security problem is inadequately restricted access to agency data, including sensitive data such as taxpayer records, personal medical information, and law enforcement data. Other

[35] *Information Security: The Melissa Computer Virus Demonstrates Urgent Need for Stronger Protection Over Systems and Sensitive Data* (GAO/T-AIMD-99-146, April 15, 1999) and *Information Security: "ILOVEYOU" Computer Virus Emphasizes Critical Need for Agency and Governmentwide Improvements* (GAO/T-AIMD-00-171, May 10, 2000).

[36] *Critical Infrastructure Protection: Comments on the National Plan for Information Systems Protection* (GAO/T-AIMD-00-72, February 1, 2000) and *Federal Information Security: Actions Needed to Address Widespread Weaknesses* (GAO/T-AIMD-00-135, March 29, 2000).

[37] *High-Risk Series: An Overview* (GAO/HR-97-1, February 1997) and *High-Risk Series: An Update* (GAO/HR-99-1, January 1999).

types of information security weaknesses include inadequacies in segregating duties to help ensure that people do not conduct unauthorized actions without detection, preventing unauthorized software from being implemented, and mitigating and recovering from unplanned interruptions in computer service. Unresolved information security weaknesses could adversely affect the ability of agencies to produce accurate data for decision-making and financial reporting because such weaknesses could compromise the reliability and availability of data that are recorded in or transmitted by an agency's financial management systems.

For example, the Department of Health and Human Services' (HHS) IG cited weaknesses in the entitywide security structure at the Health Care Financing Administration (HCFA), which administers the Medicare program.[38] HCFA relies on extensive computer operations at both its central office and the Medicare contractors to administer the Medicare program and to process and account for Medicare expenditures, which totaled more than $200 billion in fiscal year 1999. Controls over these operations are essential to ensure the integrity, confidentiality, and reliability of critical data while reducing the risk of errors, fraud, and other illegal acts. These control weaknesses do not effectively prevent unauthorized access to and disclosure of sensitive Medicare information.

In recognition of these serious security weaknesses, we have issued guides to help agencies improve security over their information systems. As mentioned previously, auditors for the 21 agencies with noncompliant systems reported weaknesses in information systems security as a cause of FFMIA noncompliance. We have identified best practices for improving information security management, which we published in two guides:

- *Information Security Management: Learning From Leading Organizations* (GAO/AIMD-98-68, May 1998) and
- *Information Security Risk Assessment: Practices of Leading Organizations* (GAO/AIMD-00-33, November 1999).

[38] *Report on the Financial Statement Audit of the Department of Health and Human Services for Fiscal Year 1999* (Report No. A-17-99-00002, February 2000).

Our guides are consistent with guidance on information security program management provided to agencies by OMB and the National Institute of Standards and Technology (NIST).[39] In addition, the May 1998 guide has been endorsed by the federal Chief Information Officers Council as a useful resource for agency managers.

All of these financial systems problems date back many years and agencies recognize the extent and severity of these financial management deficiencies. The serious and pervasive nature of these issues emphasizes the importance of developing and implementing a strategy to overcome these problems. As we discuss in the next section, agencies have prepared remediation plans to address their problems, but these plans need to be more detailed to guide agency management and staff as they resolve their agencies' financial management problems.

## Remediation Plans Continue to Lack Important Details

As required by FFMIA, agencies prepared remediation plans describing the corrective actions they plan to take to resolve their problems and bring their systems into substantial compliance with FFMIA's requirements. For our report on FFMIA compliance last year,[40] we reviewed remediation plans agencies prepared to address problems identified in the fiscal year 1997 financial statement audits. We concluded that the majority of the plans lacked sufficient detail to be adequate tools for agency management and staff to use in resolving financial management problems. For this report, we reviewed agencies' fiscal year 1998 remediation plans[41] and determined that while overall the plans improved slightly over those for fiscal year 1997, many plans still lacked detailed steps, target dates, and descriptions of the resources needed for executing the corrective actions. Further, some of the corrective actions included in the remediation plans we reviewed did not fully address the problems they are intended to

[39]OMB guidance is contained in its Circular A-130, Appendix III, *Security of Federal Automated Information Resources*, updated February 1996. NIST has issued numerous Federal Information Processing Standards as well as a comprehensive description of basic concepts and techniques entitled *An Introduction to Computer Security: The NIST Handbook*, Special Publication 800-12, October 1995, and *Generally Accepted Principles and Practices for Securing Information Technology Systems*, published in September 1996.

[40]*Financial Management: Federal Financial Management Improvement Act Results for Fiscal Year 1998* (GAO/AIMD-00-3, October 1, 1999).

[41]Remediation plans addressing issues identified in the fiscal year 1999 financial statement audits were not due to OMB until December 2000.

correct. As we reported last year, remediation plans need to be sufficiently detailed to provide a "road map" for agency management and staff to resolve financial management problems. The severity of problems facing agencies as they attempt to replace or overhaul old and outdated financial systems and resolve serious information security weaknesses, among other things, highlights the need for detailed remediation plans.

Of the 21 agencies whose systems were reported to be noncompliant with FFMIA in fiscal year 1998, 19 prepared remediation plans.[42] Two agencies—the Social Security Administration (SSA) and the Federal Emergency Management Agency (FEMA)—did not submit remediation plans for fiscal year 1998 to OMB because agency management determined that their systems were in substantial compliance with FFMIA. While SSA and FEMA management acknowledged that the weaknesses identified by the auditors exist, they did not agree with the auditors that the weaknesses resulted in lack of "substantial" compliance. SSA and FEMA have provided comments, including corrective actions, in response to the auditors' recommendations.

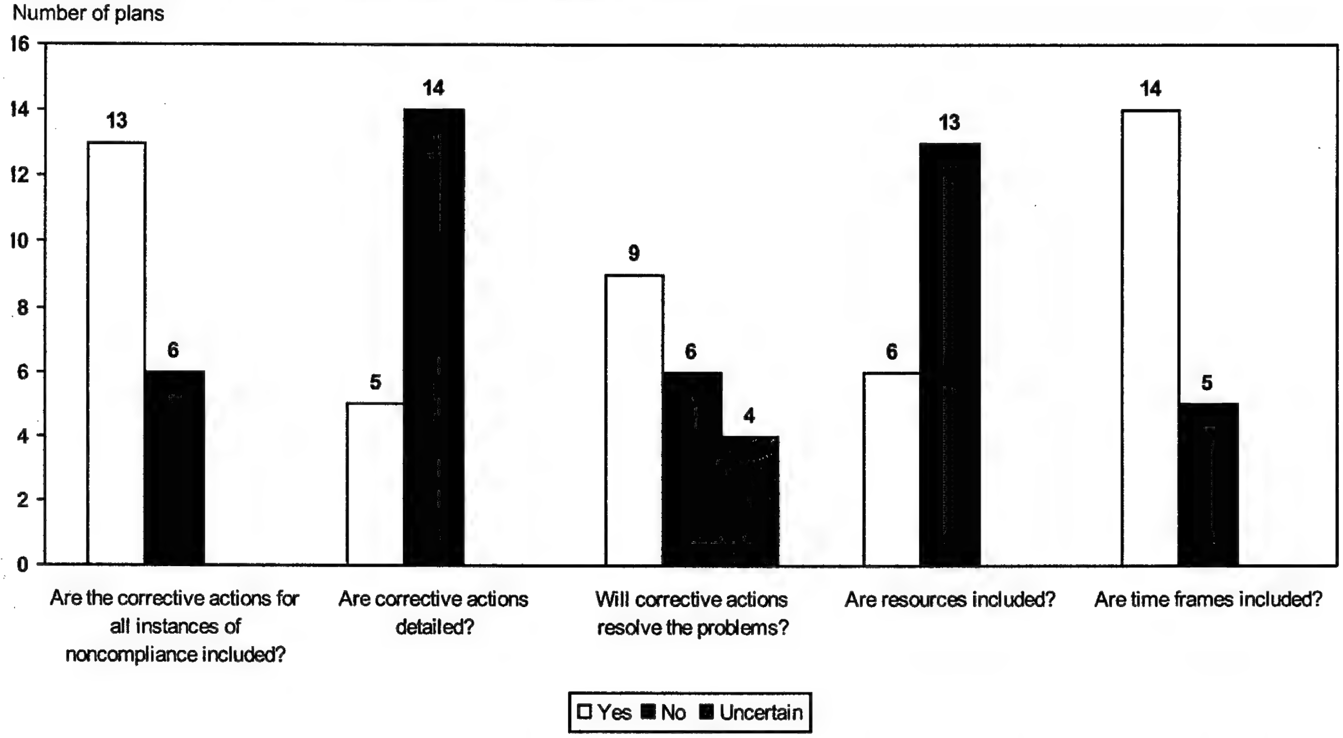
FFMIA provides that if the compliance determination of the agency head differs from the auditors' findings, the Director of OMB is to review the determinations and provide a report on the findings to the appropriate committees of the Congress. Based on discussions with OMB officials, OMB is not reviewing and has not reviewed such determinations in order to report to the Congress. According to OMB, if there is a disagreement between agency heads and auditors, agency heads can contact OMB, and OMB will work with them on the issue. Further, although FFMIA does not require a remediation plan if an agency head determines the agency's systems comply substantially, agencies are directed to address systems weaknesses in their financial management improvement plans in accordance with OMB Circular A-11.

We reviewed the 19 available remediation plans to determine whether (1) they included all the instances of noncompliance identified in the fiscal year 1998 financial statement audit reports, (2) the planned corrective actions were accompanied by detailed steps, (3) the corrective actions, if successfully implemented, would resolve the problems, (4) they included

[42]The Department of the Treasury did not prepare a departmentwide remediation plan. Rather, the bureaus and offices of the department, including the IRS, that had noncompliant systems prepared their own separate plans. For purposes of this report, we considered the individual plans together as the overall Treasury plan.

information about resources needed, and (5) they provided target dates for completing the corrective actions. Figure 1 shows the results of our analysis.

**Figure 1: Results of Review of Fiscal Year 1998 Remediation Plans**




As shown in figure 1, 13 agencies' remediation plans included corrective actions for all the reported instances of noncompliance identified during the fiscal year 1998 financial statement audits, and 6 agencies' remediation plans did not. IRS is an example of an agency that did not include corrective actions for all reported instances of noncompliance. During our audit of IRS' fiscal year 1999 financial statements, we reviewed its fiscal year 1998 remediation plan dated December 1999.[43] We reported that

[43] *Financial Audit: IRS' Fiscal Year 1999 Financial Statements* (GAO/AIMD-00-76, February 29, 2000).

although we identified noncompliance with the SGL and the inability to report cost accounting information as two reasons why IRS' systems did not substantially comply with FFMIA in fiscal year 1998, IRS' remediation plan did not include corrective actions to address these problems. However, in a June 2000 update to its remediation plan, IRS included actions to address the SGL and cost accounting issues.

Another problem we found with some remediation plans is that the corrective actions were not always detailed. As shown in figure 1, corrective actions in 14 of the 19 remediation plans were broadly stated and did not include detailed steps describing how actions are to be accomplished. An example of a plan with detailed corrective actions is HHS' remediation plan. In its plan, HHS has proposed eight corrective actions for improving its financial reporting weaknesses, including

- "Implement additional software to fully interface with [operating divisions'] systems by providing an electronic interface," and
- "Perform payroll reconciliations three times a year."

In contrast, one of the corrective actions in DOT's remediation plan is to implement an integrated financial management system that substantially complies with federal financial management systems requirements. Based on our review of DOT's remediation plan, we found no detailed steps for guiding this system's implementation. As we discuss later, when an agency's corrective actions involve implementing or replacing financial management systems, it is important to have a detailed plan that includes adopting sound information technology investment and control processes.

While there is a substantial amount of professional judgment associated with assessing the adequacy of these plans, we determined that planned corrective actions would likely not always resolve problems identified by agencies' auditors. As shown in figure 1, we determined that the corrective actions in the remediation plans of nine agencies, if successfully implemented, would probably resolve the problems. It is uncertain whether the corrective actions in the plans of four agencies would resolve their problems, and for six of the agencies, we determined that the corrective actions described in the agencies' remediation plans probably would not resolve the problems. For example, we testified in May[44] that the

[44]*Department of Defense: Progress in Financial Management* (GAO/T-AIMD/NSIAD-00-163, May 9, 2000).

Department of Defense's (DOD) fiscal year 1998 remediation plan, while an improvement over the previous plan, did not address, among other things, how the planned and ongoing improvement initiatives will result in the target financial management environment, including how the feeder systems' data integrity will be improved. Until DOD's remediation plan addresses this and other key elements there can be no assurance that the corrective actions taken will fully resolve the underlying problems.

Although OMB guidance and FFMIA state that remediation plans are to include intermediate target dates and resources necessary to achieve substantial compliance, several of the remediation plans were lacking resource information and a few of the plans were lacking target dates. As shown in figure 1, 13 of the 19 remediation plans we reviewed did not include resources needed. In the six plans that did include resources needed, the information was not always included for every corrective action. Five of the 19 plans did not include target dates; however, as was the case with resource information, when target dates were included, they were not always included for individual corrective actions. Resource information is important for agencies and OMB to determine whether corrective actions can realistically be undertaken. Setting specific intermediate target dates will help keep agencies on track as they implement corrective actions.

## Systems Replacement Projects Emphasize a Need for Detailed Plans

The importance of having a good remediation plan becomes more evident when corrective actions in remediation plans involve information technology (IT) investments, such as implementing or replacing financial management systems or software. We have reported that in the past, agencies have struggled to develop and implement new systems on time and within budget and that billions of dollars have been wasted on systems development projects.[45]

[45] *Major Management Challenges and Program Risks: A Governmentwide Perspective* (GAO/OCG-99-1, January 1999).

Planning for and executing systems development projects present major challenges for many agencies. For example, the Department of Education implemented a new accounting system that was intended to be operational for fiscal year 1998. In a December 1999 testimony,[46] we reported that pervasive weaknesses in the design and operation of Education's financial management systems, among other things, prevented Education from reliably reporting on the results of its operations in fiscal year 1998. Weaknesses in the new accounting system included the inability to perform an automated year-end closing process and directly produce consolidated financial statements as would normally be expected from such systems. The systems limitations contributed to the delay in Education submitting its fiscal year 1998 financial statements to the auditors and to Education's failure to meet the statutory due date for issuing its audited financial statements for fiscal year 1998. Because of these problems, Education's auditors recommended, among other things, that Education define and document the information system requirements needed to manage its operations efficiently.[47]

[46] *Financial Management: Financial Management Weaknesses at the Department of Education* (GAO/T-AIMD-00-50, December 6, 1999).

[47] Department of Education, *Fiscal Year 1998 Consolidated Financial Statements*, Ernst & Young LLP, November 1999.

The Department of Housing and Urban Development (HUD) also experienced problems after it failed to successfully plan and implement a new system. To correct financial management deficiencies, HUD initiated a project to design and implement an integrated financial system, HUD's Central Accounting and Program System (HUDCAPS); however, the IG found problems with the project.[48] The IG reported that the decision to implement HUDCAPS as the core accounting system for the department was made without a complete and thorough analysis of alternatives. After much effort, schedule delays, and cost increases, HUDCAPS was prepared to operate as a departmentwide system beginning in fiscal year 1999. However, the IG determined that as implemented, HUDCAPS did not fully comply with federal financial management systems requirements and that a lack of integration between program and accounting systems necessitated duplicate data entry. Further, data in a separate system at HUD's Federal Housing Authority were not updated in HUDCAPS in a timely manner. The problems with HUDCAPS caused HUD to delay closing of the general ledger and preparation of the financial statements, which, in turn, contributed to the IG's disclaimer of opinion[49] on HUD's fiscal year 1999 financial statements.

Fourteen agencies have plans to implement or overhaul their core financial management systems or to install new software. Some of these 14 agencies are in the process of implementing new systems or software, while others are in the planning stages. Implementing or overhauling financial management systems will understandably take time, and the systems may not be operational for several years. For example, HCFA has several projects planned and underway that are intended to correct problems identified during financial statement audits. As we reported in March,[50] these projects include (1) developing an integrated accounting system to include both the tracking of Medicare overpayments and financial reporting and (2) developing two new systems to improve oversight and financial reporting over Medicare receivables. While the integrated

[48] *Report on Efforts to Audit the U.S. Department of Housing and Urban Development's Fiscal Year 1999 Financial Statements* (00-FO-177-0003, March 1, 2000).

[49] A disclaimer of opinion means the auditors are unable to determine the overall fairness of the financial statements. This type of result might occur if the audit revealed the system of internal control to be grossly inadequate or if the auditors for any reason did not or could not perform sufficient work to have a basis for an opinion.

[50] *Medicare Financial Management: Further Improvements Needed to Establish Adequate Financial Control and Accountability* (GAO/AIMD-00-66, March 15, 2000).

accounting system has the potential to provide major improvements in HCFA's financial management, successful implementation will require well-defined plans and sustained management focus over the 3- to 5-year implementation period. HCFA hired an experienced systems development specialist to help ensure successful implementation of this integrated accounting system.

To ensure that IT dollars are directed toward prudent investments designed to achieve cost savings, increase productivity, and improve the timeliness and quality of service delivery, agencies need to apply the framework outlined in the Clinger-Cohen Act of 1996 and implementing guidance.[51] This includes adopting sound IT investment and control processes, designing well-developed architectures to guide information flows and technical standards, and establishing disciplined approaches for developing and acquiring computer software.

In this regard, we have worked on strengthening federal agency management of IT investment and have developed guidance based on best practices in the public and private sectors related to IT investment. Two guides resulting from our work are

- *Assessing Risks and Returns: A Guide for Evaluating Agencies' IT Investment Decision-making* (GAO/AIMD-10.1.13, February 1997) and
- *Executive Guide: Measuring Performance and Demonstrating Results of Information Technology Investments* (GAO/AIMD-98-89, March 1998).

However, it is important to remember that these guides are not a "silver bullet" to guarantee success. Rather, the key is for organizations to adopt and effectively implement policies and procedures, such as those described in the guides, that foster the necessary discipline for the organizations to produce predictable and repeatable results. Therefore, it is critical that each organization first choose the practices that are compatible with its culture and then effectively implement those practices.

OMB officials told us that they are working with agencies regarding the application of the framework outlined in the Clinger-Cohen Act. According to the OMB officials, OMB's review of agencies' IT capital asset planning

[51]The Clinger-Cohen Act builds on the best practices of leading public and private organizations by requiring agencies to better link IT planning and investment decisions to program missions and goals.

processes is linked to its review of agencies' remediation plans. This review process is discussed further in the next section.

## OMB Plays an Important Role by Providing Guidance on FFMIA Implementation Issues

OMB plays a vital role in providing agencies and auditors with guidance and ensuring that agencies have adequate resources to effect the necessary corrective actions. Specifically, OMB provides (1) guidance and assistance to agencies related to preparing remediation plans, (2) FFMIA implementation guidance for agencies and auditors, and (3) requirements for auditors of agency financial statements, including requirements for reporting compliance with FFMIA.

### Remediation Plan Guidance and Assistance

The advisory role FFMIA established for OMB with respect to agency remediation plans is important for addressing the types of problems we noted in the remediation plans we reviewed. Therefore, last year we recommended that OMB work with the agencies to ensure that all remediation plans are prepared and submitted timely. We also recommended that OMB review agencies' plans for (1) detailed corrective actions that fully address reported problems, (2) inclusion of resource requirements, and (3) specific time frames needed to implement and resolve problems.

OMB officials told us that they have adopted a new approach for reviewing agencies' remediation plans.[52] An integral part of this new approach is integrating FFMIA and financial management systems issues, especially plans to overhaul or replace financial management systems, with agencies' IT capital planning and budgeting processes. OMB officials told us that they met with officials from 20 agencies this summer to discuss their upcoming budget submissions and FFMIA remediation plans. The purpose of these meetings was to present OMB's new approach and to let managers know that FFMIA remediation plans would be considered in conjunction with agencies' capital asset plans and overall systems architectures. According to OMB officials, these meetings were attended by officials and staff from three OMB offices—the Office of Federal Financial Management, the Office of Information and Regulatory Affairs, and the Office of Federal Procurement Policy—as well as OMB's resource management officers

[52]Although this approach is new, according to OMB officials, remediation activities underway at agencies previously reported to OMB are considered in this process.

(formerly known as budget examiners) assigned to the agencies. Agency officials attending the meetings included the agencies' CFOs, chief information officers, and budget and procurement executives. In addition to the meetings held this summer, OMB has conducted training for agency managers and staff about its new approach of integrating financial management systems planning with IT strategies and capital budgeting.

OMB's new approach should help it carry out its advisory role established by FFMIA. The meetings between OMB and agency officials can provide a strategic perspective on financial and technical issues related to developing and implementing fully integrated financial management systems. With this new approach, OMB intends to ensure that remediation plans are (1) integrated into the agency's IT strategy, (2) well documented, and (3) supported by the agency's budget requests. However, because the approach is new, we cannot comment on whether it will be successful in improving agencies' remediation plans and thus improve financial management in general.

### Guidance to Agencies and Auditors

OMB has recently proposed revisions to OMB Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*. We have reviewed the proposed revisions relating to the (1) implementation guidance for agencies and auditors and (2) FFMIA compliance reporting requirements for auditors of agencies' financial statements. We are working with OMB to address our concerns.

## Other Efforts to Improve Financial Management

Other efforts across government are also underway to help agencies improve their systems and financial management overall. JFMIP tests commercial off-the-shelf software for compliance with current systems requirements and updates and issues systems requirements documents. Also, tools for auditors and agencies to use when reviewing systems for compliance with FFMIA are contained in an exposure draft of a review guide issued by JFMIP and the CFO Council and in checklists that we have published.

### JFMIP Software Certification

An important effort focused specifically on improving federal financial systems is the work of the JFMIP. In a governmentwide cooperative effort to improve federal financial systems, JFMIP established its Program Management Office (PMO) in 1998 with resources provided by the 24 CFO

Act agencies to assist agencies and vendors in developing and implementing commercial off-the-shelf software that complies with current financial management system requirements. PMO's responsibilities include, among other things, developing comprehensive testing vehicles, interpreting requirements, serving as an information clearinghouse for federal financial systems, and facilitating communication with the private sector.

In fiscal year 1999, PMO implemented a new software testing process in which it tests vendor products to certify that they meet current JFMIP systems requirements. PMO publishes the testing results in its Web-based electronic repository, called the Knowledgebase, which also includes information for agencies and vendors about financial systems requirements, business practices, and certified vendor products. JFMIP-compliant systems help assure an agency that the system properly records transactions defined in JFMIP's *Core Financial System Requirements.* However, agencies will still need to define their business requirements and then compare the various applications against those requirements to identify gaps. Once these gaps are identified, agencies need to determine the cost, schedule, and performance impacts associated with these gaps and determine the best approach to accomplishing the requirement—modifying the system or, if the desired functionality is not cost effective, eliminating the requirement. OMB Circular A-127, *Financial Management Systems,* requires that agencies replacing software to meet core financial system requirements use off-the-shelf software that has been tested and certified through the JFMIP software certification process as meeting JFMIP core financial system requirements.

## Tools for Reviewing Compliance With FFMIA

JFMIP, in cooperation with the CFO Council, has issued an exposure draft of a guide[53] to assist agencies in reviewing financial management systems as required by FFMIA and other legislation. This guide serves as a tool to assist agency managers in determining whether their agencies' financial management systems comply with FFMIA, as well as the Financial Integrity Act and OMB Circular A-127. Although the guide is written for use by agency managers, the guide will also assist auditors conducting reviews under FFMIA by helping them understand how financial and program managers evaluated their systems. As of September 2000, the exposure draft was being revised to incorporate final comments of the JFMIP Steering Committee.[54]

We have also published checklists to assist agencies in implementing and monitoring their systems and to assist management and auditors in reviewing systems to determine whether they are in substantial compliance with FFMIA. The checklists are based on JFMIP systems requirements documents. We issue them when JFMIP requirements are published for the first time and when requirements are updated. Table 6 lists the checklists we have issued in final form or as exposure drafts.

**Table 6: Checklists for Reviewing Systems Under the Federal Financial Management Improvement Act**

| Checklist | Issue date |
|---|---|
| GAO/AIMD-98-21.2.1 *Framework for Federal Financial Management System Checklist* | May 1998 |
| GAO/AIMD-00-21.2.2 *Core Financial System Requirements Checklist* | February 2000 |
| GAO/AIMD-00-21.2.3 *Human Resources and Payroll Systems Checklist* | March 2000 |
| GAO/AIMD-98-21.2.4 *Inventory System Checklist* | May 1998 |
| GAO/AIMD-21.2.5 *Seized Property and Forfeited Assets System Requirements Checklist* (exposure draft) | April 2000 |
| GAO/AIMD-21-2.6 *Direct Loan System Requirements Checklist* | April 2000 |
| GAO/AIMD-21-2.7 *Guaranteed Loan System Requirements* (exposure draft) | August 2000 |
| GAO/AIMD-21.2.8 *Travel System Requirements Checklist* | May 2000 |
| GAO/AIMD-99-21.2.9 *System Requirements for Managerial Cost Accounting Checklist* | January 1999 |

[53] *Financial Management Systems Compliance Review Guide*, JFMIP-MI-99-15, October 1999, exposure draft.

[54] The Steering Committee is responsible for the general direction of JFMIP and is comprised of representatives from GAO, Treasury, OMB, OPM, and a program agency.

## Lessons Learned From Year 2000 Efforts

The leadership and partnerships established to successfully address the Year 2000 computing problem provide valuable lessons that can also be used to address financial management reform across government. In our October 1999 FFMIA report,[55] we noted that addressing Year 2000 conversion issues was understandably a priority for federal agencies and that Year 2000 preparation had resulted in delaying financial systems changes in some agencies. We also reported that over the long term, there should be residual benefits from Year 2000 efforts. Now that the federal government has made the successful conversion to Year 2000, it can apply those valuable lessons to other critical management challenges.

We testified in January about the Year 2000 computing challenge, including lessons that can be carried forward to improve the management of information technology activities.[56] Among the lessons learned were the importance of (1) providing high-level congressional and executive branch leadership, (2) understanding the importance of computer-supported operations, (3) providing standard guidance, (4) establishing partnerships, (5) facilitating progress and monitoring performance, and (6) implementing fundamental IT improvements. The Year 2000 efforts have reinforced an understanding of the importance of consistent and persistent top management attention, which is essential to solving any intractable problem. In a recently issued report on how lessons learned can be applied to other management challenges, we reiterated that high-level management attention was key to successfully meeting the Year 2000 challenge.[57] We reported that while the Year 2000 problem was technical in nature, it was primarily a management problem, with organizations facing the risk of disruptions of their core business processes. Federal officials and other participants in a Year 2000 lessons learned summit cited high-level leadership and top management involvement as key to Year 2000 success.

According to officials at OMB, the Year 2000 problem also gave agency chief information officers a "crash course" in how to accomplish projects. Many chief information officers were relatively new in their positions, and

[55] *Financial Management: Federal Financial Management Improvement Act Results for Fiscal Year 1998* (GAO/AIMD-00-3, October 1, 1999).

[56] *Year 2000 Computing Challenge: Leadership and Partnerships Result in Limited Rollover Disruptions* (GAO/T-AIMD-00-70, January 27, 2000).

[57] *Year 2000 Computing Challenge: Lessons Learned Can Be Applied to Other Management Challenges* (GAO/AIMD-00-290, September 12, 2000).

expediting Year 2000 efforts required many of them to quickly gain an understanding of their agencies' systems, work extensively with agency program managers and CFOs, and become familiar with budgeting and financial management practices. Addressing these issues, in turn, provided them with real-time experience in responding to far-reaching management problems and in finding solutions. These experiences could prove valuable to resolving the systems issues impeding compliance with FFMIA.

## Conclusions

Long-standing problems with agencies' financial systems make it difficult for the agencies to produce reliable, useful, and timely financial information and hold managers accountable. Federal managers need this important information for formulating budgets, managing government programs, and making difficult policy choices. The extraordinary efforts that many agencies go through to produce auditable financial statements are not sustainable in the long term. These efforts use significant resources that could and should be used for other important financial-related work. For these reasons, the widespread systems problems facing the federal government need top management attention. We learned from the Year 2000 experience that proactive leadership at the highest levels of government is one of the most important factors in prompting attention and action on a widespread problem.

The federal government's size and complexity and the discipline needed to overhaul or replace its financial management systems present a significant challenge—not simply a challenge to overcome a technical glitch, but a demanding management challenge that requires attention from the highest levels of government. We recognize that it will take time, investment, and sustained emphasis on correcting deficiencies to improve federal financial management systems to the level required by FFMIA and to effectively manage government funds. The significance of the issues facing agencies, now and in the future, emphasizes the need for detailed remediation plans. As envisioned by the act, these remediation plans would help agencies establish seamless systems and processes to routinely generate reliable, useful, and timely information that would improve agencies' accountability and help them to meet the statutory deadline for issuing audited financial statements.

Because OMB's approach for reviewing agencies' remediation plans is new, we cannot yet determine whether it will be successful. As part of our next annual review of FFMIA compliance, we will evaluate whether this new approach fully addressed our recommendation in our prior report

regarding OMB's role related to ensuring the adequacy of agencies' remediation plans.

Also, until all 24 CFO Act agencies can meet the statutory deadline for issuing audited financial statements, OMB and agencies' efforts must continue. Therefore, we reaffirm the recommendation we made in our prior report that the Director of OMB require the Deputy Director for Management to work with the agencies to ensure that the agencies' financial statements are audited and issued by the March 1 statutory deadline. With concerted effort, including attention from top agency management and the Congress, the federal government can improve its financial management systems and thus achieve the goals of the CFO Act and provide accountability to the nation's taxpayers.

## Agency Comments and Our Evaluation

In comments on a draft of this report, OMB stated that it concurs with FFMIA's compliance requirements, but believes our report does not give credit for progress made or improvement efforts underway by agencies. OMB also expressed concern that, as currently written in OMB guidance, compliance requirements were black and white—meaning an agency was either compliant or not compliant. OMB stated that such an approach does not measure the progress many agencies are making in one or more of the three compliance areas—federal financial management systems requirements, applicable federal accounting standards, and the SGL at the transaction level. We agree with OMB's comment that it is important to measure progress toward improvement and acknowledge that the agencies are moving in the right direction. Accordingly, our report states that agencies are slowly making progress towards compliance with FFMIA's requirements. While FFMIA requires reporting on whether or not an agency's systems comply with the act's requirements, a number of avenues exist for reporting progress. We plan to work with OMB to enhance the reporting by agencies, auditors, and OMB on progress made in achieving compliance with FFMIA.

In its comments, OMB also discussed the applicability of information security requirements in assessing compliance with FFMIA. OMB stated that some problems relating to systems security must be addressed at a departmentwide level by the Chief Information Officer. OMB stated that many of the problems with information security that we highlighted in the report are in mixed or enterprise systems well beyond the influence of the CFO. We agree that information security is an agencywide responsibility, not limited to efforts directly under the purview of the agency CFO.

However, it is important to recognize that FFMIA not only applies to financial systems, but also to the financial portion of mixed systems. To the extent the financial and non-financial portions of mixed systems cannot be separated for purposes of information security controls, the mixed systems in their entirety necessarily are subject to FFMIA. Further, nothing in FFMIA limits its application to systems within the influence of the agency CFO. Rather, FFMIA refers only to agency systems and vests ultimate responsibility in the agency head for determining whether agency systems comply with FFMIA requirements and for establishing remediation plans. Therefore, we continue to believe that when reviewing financial management systems for compliance with FFMIA, security controls over financial and mixed systems would appropriately be included.

OMB also had numerous other comments that we incorporated into the report as appropriate. Appendix I includes OMB's comments and our responses.

We are sending copies of this report to Senator George V. Voinovich, Chairman, and Senator Richard J. Durbin, Ranking Minority Member, Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, Senate Committee on Governmental Affairs; and to Representative Stephen Horn, Chairman, and Representative Jim Turner, Ranking Minority Member, Subcommittee on Government Management, Information and Technology, House Committee on Government Reform. We are also sending copies to the Honorable Jacob J. Lew, Director of the Office of Management and Budget; the Honorable Lawrence H. Summers, Secretary of the Treasury; the heads of the 24 CFO Act agencies; and agency CFOs and IGs. Copies will also be made available to others upon request.

This report was prepared under the direction of Gloria L. Jarmon, Director, Health, Education, and Human Services Accounting and Financial Management Issues, who may be reached at (202) 512-4476 or by e-mail at *jarmong.aimd@gao.gov* if you have any questions. Key contributors to this assignment were Kay Daly, Diane Morris, Sandra Silzer, and Meg Mills.

David M. Walker
Comptroller General
of the United States

# Comments From the Office of Management and Budget

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D. C. 20503

OFFICE OF FEDERAL FINANCIAL MANAGEMENT

SEP 21 2000

Mr. Jeffrey C. Steinhoff
Assistant Comptroller General
U. S. General Accounting Office
441 G. Street NW
Washington, DC 20548

Dear Mr. Steinhoff:

Thank you for the opportunity to review the draft report "Federal Financial Management Improvement Act Results (FFMIA) for Fiscal Year 1999."

As we discussed on September 13th, I believe we share a common goal to improve Federal financial management by building and maintaining financial systems that comply with the FFMIA. Specifically, the law requires systems should substantially comply with: (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Standard General Ledger at the transaction level.

See comment 1.

At this point in time, I believe it is important to measure progress toward improvement and acknowledge that the agencies are moving steadily in the right direction. At our meeting, I expressed my concern that, as currently written in OMB's guidance, compliance requirements were black and white-an agency was either compliant or not compliant. Such an approach does not measure the progress many agencies, and more specifically major components of agencies, are making in one or more of the three compliance areas. We agreed that the improvements necessary to bring systems into compliance have a lengthy time frame.

I concur with FFMIA's compliance requirements; but I would like to see some acknowledgment that agencies are making progress. As it reads now, the report is very negative and does not give any credit for either progress made by agencies or current improvement efforts underway. Also, the report highlights numerous non-FFMIA problems with information security, some in financial management systems that are FFMIA, but many in mixed or enterprise systems well beyond the influence of the Chief Financial Officer. As we discussed at our meeting last Wednesday, we must stay focused on financial systems security, recognizing that some problems must be addressed at a department wide level by the Chief Information Officer and not on an individual system approach.

Thank you for considering my views. Please feel free to call me on (202) 395-3993 if you would like to discuss this issue further. Specific comments are provided in the enclosure to this letter.

Sincerely,

Joseph L. Kull
Deputy Controller

Enclosure

## Comments

**"Federal Financial Management Improvement Act Results for Fiscal Year 1999"**
**(presented by draft page number)**

See comment 2.

Now on pp. 4 and 38.

1. Pages 5 and 48 contain a discussion of OMB's process for reviewing remediation plans and states that the approach being used will begin with the FY 1999 plans. The discussion should mention that any remediation activities underway at agencies previously reported to OMB are being considered in this process and have been the basis of our discussions with agencies on FFMIA compliance. The approach is not limited to those being activities being reported in the FY 1999 plans

See comment 3.

Now on p. 11.

2. Page 12 states "AAPC's efforts result in authoritative guidance for preparers and auditors of . . ." We recommend substituting the word "authoritative" with "implementation." While AAPC documents now become part of the Federal GAAP hierarchy for accounting matters, AAPC documents are not necessarily authoritative for audit matters. The authoritative nature of AAPC documents is being deliberated currently. The suggested edit should address this matter for purposes of this report.

See comment 4.
Now on p. 11.

3. Page 13 presents Table three containing a column titled "Release date." "AAPC Release Date" would be a more accurate title since TR-3 and TR-4 have been issued by AAPC but have not been issued by OMB.

See comment 5.

Now on p. 14.

4. Page 17 states "This continuing widespread noncompliance with FFMIA is indicative of the overall longstanding poor condition of agency financial systems." The statement is factually true as to the noncompliance with FFMIA however it does not recognize that progress has been made to correct problems within the individual agency systems. Interim steps towards progress in correcting longstanding system problems cannot be show since the agency's FFMIA determination shows overall agency, not individual system, compliance. Credit should be given to the efforts of agencies to improve their systems.

See comment 6.

Now on p. 15.

5. Page 17 also states "Fifteen of the 24 CFO Act agencies received unqualified audit opinions on their financial statements for fiscal year 1999, up from 12 in fiscal year 1998 and 11 in fiscal year 1997. Yet FFMIA noncompliance has been fairly consistent since fiscal year 1997 when the systems of 20 of the 24 CFO Act agencies were reported to be noncompliant." Based upon the discussion in this report on agencies using "heroic efforts" to produce financial statements it appears a correlation between clean opinions and FFMIA compliance cannot be drawn. Some consideration should be given to the fact that improved systems may have assisted in providing better and more timely financial statement information even if an agency is not in overall compliance with FFMIA.

See comment 7.

Now on pp. 16-17.

6. Pages 18-20 present Table four. We suggest the following changes:

See comment 7.

See comment 8.

- add a column showing the agency head's determination of substantial compliance with FFMIA since this is the key determination required by the law.
- recognize Education as receiving a qualified opinion in the chart totals
- show a disclaimer audit opinion for the financial statements of OPM

The changes to include Education as a qualified opinion and OPM as a disclaimer 2will reconcile the 1999 actual results reported by the Administration with the results included in this report. We believe it is most helpful to consistently report this information, unless we have substantive difference (which is not the case in this situation).

See comment 9.
Now on p. 17.

7. Page 20 states "Financial statement audit results are key indicators of the quality of agency financial data at year-end and provide an annual public scorecard on accountability." There are other key indicators of quality financial data such as the ability to provide financial data to program managers that is timely and useful. Financial statements, not their audits, provide accountability to the public. We suggest revising this sentence to state, "Financial statements demonstrate agency accountability to the public."

See comment 10.
Now on p. 18.

8. Page 21 states "The results shown in table 4 indicate that, although auditors reported that the financial statements of 15 of the 24 CFO Act agencies were fairly presented and reliable at the end of the fiscal year, the financial systems of 21 of the 24 agencies have weaknesses, some of which are so serious that they are not able to routinely provide reliable, useful, and timely information on an ongoing basis." The basis for drawing this conclusion should be explained in the report.

See comment 11.
Now on pp. 19 and 20.

9. Page 23 discusses the information on Table 5. The narrative should mention that the agency heads of three additional agencies disagreed with their auditors on FFMIA compliance. In addition Table 5, shown on page 24 should be organized to show the three areas of the law: systems requirements, applicable Federal accounting standards, and SGL compliance. The columns now used for system integration, reconciliation procedures, and security do not cover the scope of system requirements that must be satisfied for FFMIA compliance. Should additional breakouts of specific system requirements be presented they should be shown as subsets of the system requirements.

See comment 12.

Also, the table should be revised to show the following:
- Non-compliance with the SGL for NRC as they reported their program cost accounting is not performed through the general ledger due to SGL problems.
- Compliance with the SGL for Justice nor EPA as findings for this area was not cited in the auditor's reports.

See comment 13.
Now on pp. 21 and 23.

10. Page 25 has a separate section discussing nonintegrated financial management systems. Page 28 has an additional section discussing reconciliations. These are only two of the many examples of system requirements. Consideration should be given to presenting system requirements in a single section titled as such. The current presentation might lead a reader to believe other system requirements are less significant.

See comment 14.
Now on p. 27.

11. Page 33 contains a discussion of information security weaknesses. This discussion should highlight that most of the weaknesses cited resulted from problems with an agency's overall information security infrastructure and impacting all agency information technology systems. The report should put the problem in perspective and state that these problems must be addressed on an agency wide basis, but not within the scope of individual financial management systems covered by FFMIA. Page 34 cites specific security problems such as access to personal medical information. Examples such as these show the problems to be programmatic and beyond the scope of financial management systems.

Now on p. 27.

See comment 15.
Now on pp. 28 and 20.

12. Page 35 discusses information systems security problems reported by auditors at 20 agencies. This amount is inconsistent with Table 5 on page 24 that shows 21 agencies.

See comment 16.
Now on p. 30.

13. Page 38 states "According to OMB, if a disagreement cannot be resolved within the agency, the agency head is to send a formal letter stating the disagreement and requesting that the Director of OMB make a decision." This statement is not completely accurate. A more accurate statement is "According to OMB, if there is a disagreement between management and the auditors, agencies can contact OMB and it will work with them on the issue." Agencies do not need to send a formal letter to request OMB assistance. Since the passage of FFMIA, OMB has met with agency managers and auditors to discuss these situations. However, formal letters are required when the agency disagrees with the auditor's determinations. This notification is usually incorporated in the financial statement transmittals to OMB. OMB was notified by the three agencies identified in this report as being in disagreement with their auditor's findings.

See comment 17.
Now on p. 30.

14. Page 38 also states "According to the OMB officials, as long as the agencies recognize their problems and are addressing them, then OMB will not require a separate FFMIA remediation plan." This statement applies to agencies in substantial compliance with FFMIA as the law does not require a plan from those agencies. Agencies in compliance with FFMIA are directed to address system weaknesses in their financial management improvement plans through the guidance provided in Section 52.4(3) of OMB Circular A-11. This should be clarified in the report.

See comment 18.
Now on p. 33.

15. Page 41 provides a discussion of the elements of remediation plans including resource requirements. OMB views the resource information agencies provide in their capital asset plan exhibits and information technology portfolios as satisfying this requirement. In OMB's approach to reviewing remediation plans we consider the whole IT capital plan that includes capital asset plans, information technology portfolios, financial management plans, and other related documents.

See comment 19.
Now on pp. 36, 4, and 37.

16. Page 45 refers to implementing the framework in Clinger-Cohen to ensure that IT dollars are directed towards prudent investments. The approach mentioned on pages 5 and 47 used by OMB for monitoring agency FFMIA remediation activities is the same as the process used by OMB to review an agency's information technology capital asset planning process. This process links FFMIA remediation activities with the framework prescribed in Clinger-Cohen. This link should be highlighted in the report so that agencies recognize that financial

management system investments required for FFMIA remediation activities are part of the agency IT capital asset plan.

See comment 20.
Now on p. 37.

17. Page 46 states, "Specifically, OMB provides (1) guidance and assistance to agencies related to preparing remediation plans and (2) FFMIA audit guidance for agency auditors." This statement would be more accurate by stating, "Specifically, OMB provides (1) guidance and assistance to agencies related to preparing remediation plans, (2) FFMIA implementation guidance, and (3) audit requirements for financial statements including those for auditor reporting prescribed by FFMIA.

See comment 21.
Now on p. 38.

18. Page 49 states "Also, FFMIA compliance guidance is contained in an exposure draft of a review guide issued by JFMIP and the CFO Council and in checklists that we have published." OMB provides implementation guidance for FFMIA. The document JFMIP is preparing, the "Systems Compliance Review Guide", as well as the GAO checklists are tools available for reviewers to use in assessing compliance. They should not be considered guidance because they do not establish policy or requirements agencies must follow. The reference to guidance also should be corrected in the section starting on page 50.

Now on p. 40.

See comment 22.
Now on p. 40.

19. Page 50 states, "As of August 2000, a revised version of the exposure draft was pending issuance while awaiting comments from OMB and the Department of Treasury." If OMB and the Department of Treasury have comments at this point in the review process they identify problems with the exposure draft and not a mere sign-off of a final product. This statement should be revised to indicate the systems compliance review guide is being revised to incorporate the final comments of the JFMIP Steering Committee.

The following are GAO's comments on the Office of Management and Budget's September 21, 2000, letter.

## GAO Comments

1. See "Agency Comments and Our Evaluation" section.
2. The report was revised to address OMB's comment.
3. The report was revised to address OMB's comment.
4. The report was revised to address OMB's comment.
5. See "Agency Comments and Our Evaluation" section.
6. We disagree that a correlation between clean opinions and FFMIA compliance cannot be drawn. The report is intended to convey the message that some agencies had to use "heroic efforts" to produce financial statements because their systems could not produce them. One of the reasons the systems could not produce the financial statements is because they do not comply with FFMIA's requirements.
7. The main source for this section of the report is agency audit reports. Therefore, table 4 summarizes auditors' FFMIA determinations and financial statement opinions. To address this concern, we added a note to the table that discusses determinations made by agency management. We also discuss the agencies that disagreed with their auditors' FFMIA determinations in footnote 18 on page 14 and in the remediation plans section on page 30.
8. The report was revised to address OMB's comments.
9. We agree that the ability to provide financial data to program managers that is timely and useful is a key indicator of the quality of financial data. This is the end game that we discuss in our report. At the same time, we do not agree that results of financial statement audits do not provide a measure of accountability to the public. Audit results show whether the information in the financial statements is reliable and fairly presented. Audit results have been one of the key indicators for both government and private industry to provide accountability.
10. Language was added to the report to show that the basis for this conclusion is discussed in the sections that follow.

11. The purpose of table 5 is to show the most commonly reported problems relevant to FFMIA, as explained in the paragraph preceding the table. As discussed in the text, this table covers more than specific reasons for noncompliance with FFMIA, so a discussion of agencies' FFMIA determinations is not appropriate here. Table 4 shows the three requirements in the law—systems requirements, applicable federal accounting standards, and SGL compliance—and what auditors reported regarding these three areas.

12. The changes suggested by OMB in its comments illustrate the need to clarify guidance to auditors for reporting on compliance with FFMIA. We note that OMB's recently proposed revisions to the audit guidance in Bulletin 98-08 should help to do this.

    We have revised tables 4 and 5 to show that NRC experienced difficulties complying with the SGL requirements of FFMIA. We agree that the consolidated audit report for the Department of Justice did not specifically mention noncompliance with the SGL. However, the consolidated audit report referred to component audit reports. The auditors of the Immigration and Naturalization Service (INS), a major component of the Department of Justice, cited noncompliance with the SGL in the INS' audit report; therefore, we included this as a problem reported by auditors (table 5). Regarding the Environmental Protection Agency (EPA), the audit report stated that, in most cases, EPA could not report its intragovernmental assets and liabilities by trading partner because finance offices were not coding transactions to show this information. We interpret this as a SGL noncompliance issue because reporting intragovernmental transactions by trading partner is an SGL requirement.

13. We did not intend to imply that other systems requirements are less significant. Our intention was to highlight major areas needing attention that were most often cited by auditors.

14. See "Agency Comments and Our Evaluation" section.

15. The report was revised to address OMB's comment.

16. The report was revised to address OMB's comment.

17. The report was revised to address OMB's comment.

18. We reviewed fiscal year 1998 remediation plans that were prepared before OMB adopted this new approach for reviewing the plans. Fiscal year 1999 remediation plans are not due to OMB, and therefore will not be available, until December 2000. We believe that OMB's approach to consider the whole IT capital investment plan has merit, and as part of our work for next year's report, we will review this approach. At the same time, FFMIA requires that remediation plans contain resources, and therefore, elements of the remediation plan that are included in other documents should be referred to in order to assist the plan's users and fulfill the requirements of FFMIA. The fiscal year 1998 remediation plans we reviewed generally did not refer the reader to IT capital investment plans to identify resources needed.

19. The report was revised to address OMB's comments.

20. The report was revised to address OMB's comments.

21. The report was revised to address OMB's comments.

22. The report was revised to address OMB's comments.

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